

This letter concerns installation of security systems. See 86 Ill. Adm. Code 130.1940. (This is a GIL.)

December 31, 2007

Dear Xxxxx:

This letter is in response to your letter dated June 14, 2007, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

Please accept this letter as a request for a letter ruling on the taxability of the following situation.

CORPORATION provides security services and is incorporated in Illinois. CORPORATION has a qualified subsidiary, 'SUBSIDIARY' (a division of CORPORATION) who provides consulting and management of closed circuit television design and installation. These digital video surveillance systems are designed and used for security enhancement. SUBSIDIARY has three services for which CORPORATION bills on their behalf. Some of the locations where SUBSIDIARY provides digital video surveillance systems, CORPORATION provides the security services. In these cases, CORPORATION employees will be the operator of the closed circuit television system that is installed by SUBSIDIARY.

The three items for which CORPORATION invoices on behalf of SUBSIDIARY are,

1. SUBSIDIARY sends representatives to client locations and provides consulting and design services for digital video surveillance systems. These services include, meeting with client to define operational parameters, physical property review, and reports of technical recommendations and cost estimates.

CORPORATION invoices consulting fee and associated expenses incurred by the representatives who travel to these locations.

2. SUBSIDIARY provides project management during the installation of digital video surveillance systems. Project management includes, pre installation meetings with the installation contractor, progress and technical inspection during the installation to insure compliance with project specifications, system set up and programming, training sessions with operators, and comprehensive inspection and certification following installation. CORPORATION invoices the project management fee as well as associated expenses that SUBSIDIARY employees incur while working on these projects.
3. At the client's option, SUBSIDIARY will facilitate the acquisition of all the required recommended equipment for a given project. SUBSIDIARY acquires these items on behalf of the client. When SUBSIDIARY acquires these items, the vendor charges sales tax at the rate of the location to which they are being delivered. CORPORATION invoices customers the exact cost incurred on these items, and a 5% management fee for the service and convenience that SUBSIDIARY provides.

CORPORATION is requesting a letter ruling for the following questions concerning the billing practices with SUBSIDIARY. Enclosed is a sample invoice for services provided by SUBSIDIARY.

At locations where SUBSIDIARY provides services:

1. What is the taxability of the consulting services provided in item 1?
2. What is the taxability of the project management provided in item 2?
3. What is the taxability of the previously taxed items that CORPORATION invoices in item 3?
4. What is the taxability of the management fee that CORPORATION invoices in item 3?
5. Does the taxability of the above items change if CORPORATION provides security services at the location?

If you have any questions, please feel free to contact me. Thank you for your time and consideration with this matter.

## **DEPARTMENT'S RESPONSE:**

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois.

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use

Tax liability for the servicemen depending upon his activities. See 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (*i.e.* servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. The serviceman's liability may be calculated in one of four ways: (1) separately-stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered *de minimis* servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are *de minimis* and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately-stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to *de minimis* servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. See 86 Ill. Adm. Code 140.109. Servicemen may qualify as *de minimis* if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are *de minimis* using a transaction by transaction basis. Registered *de minimis* servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen also collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

The final method of determining tax liability may be used by *de minimis* servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such *de minimis* servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108.

The provision of engineering, design, consulting services or project management services that does not include the transfer of tangible personal property with the provision of the such services does not result in Service Occupation Tax or Use Tax liability. The transfer of any tangible personal property such as, for example, written reports, tangible media (CDs) and training manuals incident to a sale of service and would be subject to liability under one of the four methods described above.

If a business agrees to sell and install a security system so as to make it a permanent part of a building, the business is acting as a construction contractor. A construction contractor is deemed to be the end user of the materials which it takes off the market and incorporates into real estate. The construction contractor will incur Use Tax on its cost price of the tangible personal property incorporated into real estate. When a construction contractor subsequently sells and installs property in a fashion that makes the property a real estate improvement, there is no sales tax due because sales tax does not apply to sales of real estate improvements. The contractor simply discharges the tax liability "up front" by paying tax at the time he buys the materials. See 86 Ill. Adm. Code 130.1940.

When a business sells and installs a security system, the customer incurs no Use Tax and, as a construction contractor, the business has no authority to collect Use Tax from the customer. Many construction contractors pass on the amount of their Use Tax liabilities to customers in the form of higher prices or by including provisions in their contracts that require customers to "reimburse" the construction contractor for its tax liability. Please note that this reimbursement cannot be billed to a customer as "sales tax," but can be listed on a bill as a reimbursement of tax. The choice of whether a construction contractor requires a tax reimbursement from the customer or merely raises its price is a business decision on the construction contractor's part.

In the specific case of installers of security systems, Section 1 of the Retailers' Occupation Tax, in an attempt to ease the burden of administration, provides specifically that "[c]onstruction contracts for the improvement of real estate consisting of engineering, installation, and maintenance of voice, data, video, security, and all telecommunication systems do not constitute engaging in a business of selling tangible personal property at retail within the meaning of this Act if they are sold at one specified contract price." See 35 ILCS 120/1. "This provision applies to all of the items . . . even if they are not incorporated into real estate." 86 Ill. Adm. Code 130.1940(c)(3).

As a result of the statutory and regulatory language, installers of security systems are authorized to pay Use Tax to their providers on all equipment and supplies they purchase related to the security systems they sell and install, even if some of those supplies are not technically incorporated into real estate, such as the cameras, computers and monitors. This provision applies if the sale and installation of the security systems are packaged for one specified contract price.

I hope this information is helpful. If you require additional information, please visit our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Richard S. Wolters  
Associate Counsel

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